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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992	)	MM Docket No. 92-266
	)	
Rate Regulation	)	

REPLY COMMENTS OF THE NATIONAL CABLE TELEVISION ASSOCIATION

The National Cable Television Association, Inc. hereby submits its reply comments on the Further Notice of Proposed Rulemaking in the above-captioned proceeding.

INTRODUCTION

The issue in this proceeding is whether, in calculating "benchmarks" for purposes of rate regulation pursuant to the Cable Television Consumer Protection and Competition Act of 1992 (the "Act"), the Commission should include or exclude the rates that are charged by systems with penetration of less than 30 percent. The benchmarks are intended to reflect the rates charged by systems subject to effective competition, and the Act defines such systems to include those with penetration of less than 30 percent. But because the rates of such systems appear to be higher than the rates of other systems that also are defined by the Act to be subject to effective competition, the Commission is considering excluding them from the analysis and, as a result, lowering the benchmarks.

The Commission, in its Further Notice, indicated some concern that, factual and policy issues aside, it might be precluded by the Act from excluding systems with less than 30 percent penetration from its benchmark calculation. In our comments, we showed that this, indeed, is the case.

First, as a matter of law, Congress has determined that systems with less than 30 percent penetration are to be treated, for all purposes under the statute, as systems that face effective competition. To the extent that rate regulation standards are to consider or take into account the rates charged by systems subject to effective competition, those rates must include the rates of all systems subject to effective competition. And to the extent that those standards are to be designed to ensure that rates reflect those that are charged by systems subject to effective competition, they are to reflect rates charged by all systems subject to effective competition. Those systems include systems with less than 30 percent penetration.

Second, as a matter of logic, we also showed, in our comments, the fallacy of concluding that, simply because low-penetration systems have higher rates than other systems that face effective competition, those rates should not be viewed as "competitive." As we showed, it is at least as likely that municipally owned systems and systems facing head-to-head competition from other cable systems charge rates that are too low to recover costs plus a reasonable profit as that low-penetration systems charge rates that are too high.

Because the effect of excluding low-penetration systems from the benchmark analysis would, according to the Commission, be to reduce rates by yet another 18 percent, a number of commenting parties whose principal objective is low rates -- municipalities, consumer organizations, and telephone companies[1] -- support such a

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1 For reasons that we have stated throughout this proceeding, consumers' interests with respect to cable service are not always best served by requiring lower rates -- because, for example, lower rates may mean a reduction in the quality and quantity of cable
(Footnote cont'd)

revision. But their arguments reflect the same legal and logical fallacies that we discussed in our comments. In particular, their analyses are based on anecdotal evidence and conjecture as to the possible reasons why low-penetration systems have higher rates than systems facing overbuild competition -- and completely ignore the likely and plausible explanations (1) that low-penetration systems simply have higher costs and (2) that systems facing overbuild competition charge prices too low to cover costs plus a mandate that rates -- at least basic rates -- reflect those that would be charged by a system if it were subject to effective competition.[3]

In other words, it is not simply that the Commission must consider the rates of all systems subject to effective competition in calculating its benchmarks. It is that the point of the benchmark approach is to ensure that rates approximate those of systems that are subject to effective competition. Only by including all systems subject to "effective competition" -- a term clearly defined in the Act -- in the benchmark analysis can the Commission ensure that the resulting benchmarks reflect the rates of all those systems identified by Congress. If the Commission excluded rates of systems with less than 30 percent penetration from its benchmark analysis, it would, in effect, be designing the benchmarks to reflect rates of systems that it defined as subject to effective competition -- rather than to reflect rates of systems that the Act defines as subject to effective competition. This, as a matter of law, it may not do.[4]

The Consumer Federation of America ("CFA"), by failing to focus on the language of the statute, misstates the Commission's mandate and, therefore, misses the point. CFA points out that "[t]he Commission has been directed to ensure that rates for the basic tier are reasonable," and states that "[t]he definition of reasonableness, for

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3 See 47 U.S.C. §623(b)(1): "Such regulations shall be designed to achieve the goal of protecting subscribers of any cable system that is not subject to effective competition from rates for the basic service tier that exceed the rates that would be charged for the basic service tier if such cable system were subject to effective competition."

This directive applies only to regulation of basic rates. As we have argued throughout this proceeding, most recently in our Petition for Reconsideration, Congress intended that rates for non-basic "cable programming services" be subject to a more flexible standard designed to rein in systems whose overall rates far exceeded the norm. The Commission has decided that non-basic rates should be subject to the same standards the statutory standard for basic rates, and the benchmarks are intended to implement that standard.

4 See NCTA Comments at 5-9.

purposes of the 1992 Cable Act, means rates that would be charged if a system were subject to competition."[5] Therefore, according to CFA, the Commission's mandate is to ensure "competitive"[6] rates -- and, to the extent that systems with low penetration seem not to charge "competitive" rates, they should be excluded from the benchmarks.[7]

But the definition of reasonableness is not what would be charged if a system were "subject to competition"; it is what would be charged if a system were "subject to effective competition." And while the Commission might have had discretion to define and determine which systems were "subject to competition" or which systems' rates were "truly competitive,"[8] it is not free to decide which systems are "subject to effective competition". That decision has been made and codified by Congress.

Thus, the requirement that the Commission consider the rates of all systems subject to effective competition -- including systems that have penetration of less than 30% -- in adopting standards for ensuring reasonable rates is not a mere "peculiarity in Congressional directives," as CFA suggests.[9] To the contrary, the rates of all such systems specified in the statute provide the standard of reasonableness. Basic rates are reasonable if they reflect rates charged by systems subject to effective competition -- and Congress has determined conclusively which rates and which systems those are.

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5 CFA Comments at 5.

6 Id. at 7.

7 Id.

8 Id.

9 Id.

II. There Is No Basis For Giving Low-Penetration Systems Lesser Weight in the Benchmark Calculations.

NATOA argues that even if the Act requires the Commission to include systems with penetration of less than 30% in its benchmark calculations, "the Commission should discount the weight accorded rates charged by such systems, given that a disproportionate number of them serve small franchise areas."[10] According to NATOA, 46% of the systems identified by the Commission as having less than 30% penetration are systems serving franchise areas with 1,000 or fewer subscribers, while only 19.5% of systems facing head-to-head competition from another multichannel provider have fewer than 1,000 subscribers. Because small systems typically have higher costs and higher rates than larger systems, NATOA argues that the disproportionate number of small systems in the sample unduly affects the average rates of systems subject to effective competition.

If the Commission were simply comparing the average rate per channel of effectively competitive systems to the average rate per channel of regulated systems, without holding any factors constant, then NATOA might have a valid criticism. But this is not the case. The Commissions econometric methodology has already taken into account NATOA's concern.

In determining the competitive adjustment through its "regression analysis", the Commission took into account various factors that affect rates per channel: number of subscribers, number of channels, number of satellite-channels. In effect, by taking these factors into account, the Commission looked at "similarly situated" cable systems. One of these factors was the number of subscribers. By including a subscriber variable in the econometric analysis, the Commission has already taken into account variations in rates that are accounted for by system size, measured by the number of subscribers. The relative percentage of small franchises in the two samples is therefore not a matter for

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10 NATOA Comments at 8 (emphasis added).

concern in this respect. (If the Commission had not included a measure of subscribers in their econometric analysis, the Commission would have found a smaller competitive differential for the reason stated by NATOA.)

In any event, if the Commission were to begin refining its benchmarks further, it would hardly be sufficient simply to adjust the benchmarks upwards or downwards. For example, we showed in our Petition for Reconsideration in this proceeding that the Commission's assumption of a uniform 10% difference between systems that are and are not subject to effective competition was erroneous. Specifically, we showed that, for systems with fewer than 5,000 subscribers, the differences between rates of competitive and non-competitive systems was even larger than 10% -- but that for systems with more than 5,000 subscribers, there were no significant differences.[11] Therefore, if the Commission were to adjust its benchmarks to take account of any disproportionate number of small systems in its sample of systems subject to effective competition, it would also be appropriate to adjust the benchmarks so that benchmarks for systems with more than 5,000 subscribers no longer reflect a 10 percent downward adjustment to reflect the supposedly lower rates of systems subject to effective competition.

III. There Is No Evidence That the Rates of Systems With Penetration Less Than 30% Are Higher Than "Competitive" Levels -- And Reason To Believe That the Rates of Municipally Owned Systems and Systems Facing Head-to-Head Competition Are Below Competitive Levels.

The parties seeking lower benchmarks argue that the rates of systems with less than 30 percent penetration are significantly higher than the "truly competitive market systems"[12] that face head-to-head competition, and that, therefore, those rates must be supracompetitive. But the mere difference in rates does not itself demonstrate that rates

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[11] See NCTA Petition for Reconsideration at 15.

[12] CFA Comments at 4.

of low-penetration systems are supracompetitive. There are at least two obvious alternative explanations for the differences.

First, it is possible that the difference in rates are accompanied by differences in costs. If the costs of systems with penetration of less than 30% are higher than the costs of systems with head-to-head competition, then higher rates would be necessary to recover costs plus a reasonable profit. They would not be indicative of supracompetitive prices or an absence of effective competition. Yet none of the commenting parties' analyses purport to assess the effects of different costs on the different rates of low-penetration and head-to-head competitive systems. For example, as the attached report of Economists Incorporated points out, the affidavit of Thomas Hazlett on behalf of Bell Atlantic, et al.

> notes that many low penetration systems are small, rural operators. There may be factors associated with those types of systems that cause them to have higher costs on average. Neither Hazlett nor the FCC has examined the costs associated with the low penetration systems.[13]

Indeed, NATOA's comments suggest that different costs do account for the differences in rates. NATOA points out that "smaller systems' costs are significantly higher than larger systems."[14] And NATOA also points out that almost half the systems with less than 30 percent penetration, but only 19.5 percent of the systems facing head-to-head competition, are systems with fewer than 1,000 subscribers. The fact that the low-penetration systems in the sample include many more systems with under 1,000 subscribers than the systems facing head-to-head competition means that the low-penetration systems are likely, on average, to have higher costs. And these higher costs -- rather than an absence of effective competition -- would explain higher rates.

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[13] Economists Incorporated, "Comments on Hazlett Analysis" 2. The report generally describes the serious methodological shortcomings of Hazlet's affidavit.

[14] NATOA Comments at 9.

Second, as we argued in our initial comments, the mere fact that the rates of low penetration systems are higher than those of municipally owned systems and systems facing head-to-head competition does not, in itself, indicate that rates of low-penetration systems are supracompetitive -- because the rates of the other systems may be lower than competitive levels. As we showed, overbuild systems may be engaged in price wars or face "greenmail" situations that result in rates below what is necessary to recover a reasonable profit. And municipally owned systems typically are not intended to be profitable.[15]

None of the cities, consumer groups and telcos that seek to lower the benchmarks provide any evidence to show that the rates of systems facing head-to-head competition or those of municipally owned systems are, in fact, "truly competitive", as CFA suggests. Yet absent such evidence, it is impossible to argue for the exclusion of systems with less than 30 percent penetration. If, as seems likely, those systems' rates are on average below what is necessary to recover costs plus a reasonable profit, then it may be the case that it is the low-penetration systems' rates that are "truly competitive" and the other systems' rates that should be excluded. Or, even if the low-penetration systems' rates were, to some extent, higher than a competitive level, the overall average rates of all systems subject to effective competition might still be at or below a competitive level.

In short, even if the Commission had authority to exclude systems with less than

CONCLUSION

For the foregoing reasons, and for the reasons set forth in our initial comments, the Commission should not further reduce the rate benchmarks by excluding from its analysis systems with penetration of less than 30 percent.

Respectfully submitted,

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COMMENTS ON HAZLETT ANALYSIS

Hazlett[1] assumes that if rates are high, then the franchise area must be non-competitive. This simply does not follow. The Commission's data indicate that among overbuild systems, which Hazlett states are "indisputably competitive," some have rates higher than other overbuild systems, some have rates higher than regulated systems, and some have rates higher than low penetration systems.

approximately the same. Moreover, as Dertouzos and Wildman[2] point out in their comments, there are additional factors that affect rates that the Commission did not take into account in its analysis. Dertouzos and Wildman argue that including additional factors in the econometric analysis may reduce the rate differential between overbuild systems and regulated systems. Similarly, including additional factors in the analysis may also reduce the average rates of low-penetration systems not only from Hazlett's unadjusted figure of 10 percent above regulated systems to the Commission's finding of no difference, but even to a level below that of the regulated systems' rates.

One explanation for higher rates for low penetration systems is that they may simply face higher unit costs than the average regulated or overbuild system. Hazlett notes that many low penetration systems are small, rural operators. There may be factors associated with these types of systems that cause them to have higher costs on average. Neither Hazlett nor the Commission has examined the costs associated with low penetration systems.

Hazlett argues that high rates may be a cause of low penetration. Clearly, all else equal, higher rates would decrease the number of subscribers. But Hazlett has not held all else constant. It may be that high cost factors necessitate high rates which may or may not result in fewer subscribers, depending upon the nature of demand in the market. The simple presence of high rates conveys no information about the nature of the demand curve or the competitiveness of the market. Even in a both price and penetration." Again, Hazlett ignores the fact that factors other than the demand elasticity are likely to vary across systems and franchise areas. A system may face a very elastic demand curve, but if it has high costs it will still have high rates.

Hazlett assumes that unless a cable system faces competition from a multichannel video distribution service there is no competition, as if the statute redefined the science of economics. As any economist familiar with this industry knows, cable systems face competition from sources other than multichannel video distribution services. The Commission itself has previously measured competition in terms of over-the-air broadcast signals. Hazlett is looking for a specific "statutory" competitor, and ignoring the fact that real-world competition could come from other sources. In short, low-penetration systems may well face effective economic competition whether or not they face a multichannel video distribution service.

Hazlett also argues that systems reporting less than 30 percent penetration should not be believed because they have an incentive to underreport the number of their subscribers in order to avoid regulation. The Commission staff has taken this potential problem into account by verifying each system's claim of satisfying either the low penetration or overbuild criteria. The Commission did not simply take a respondent's word that a system met one of the effective competition criteria; it conducted its own analysis.